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No. 94 68

CHARLES E. HOPE CROSLEY

Supreme Court of the United States

BEULAH B. CRANE,

Petitioner,

(Respondent in the Circuit Court of Appeals and Petitioner in the Tax Court),

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent,

(Petitioner in the Circuit Court of Appeals and Respondent in the Tax Court).

PETITION FOR WRIT OF CERTIORARI

and

BRIEF IN SUPPORT THEREOF.

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To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

The petitioner, Beulah B. Crane, for her petition herein, respectfully shows to this Honorable Court as follows:

I.

Pursuant to subdivisions (a) and (b) of Rule XXXVIII of this Honorable Court, your petitioner respectfully applies for a writ of certiorari to review the decision and judgment of the United States Circuit Court of Appeals, Second Circuit, rendered in the above-entitled proceeding on December 28, 1945, reported 153 F. 2d 504, which reversed the determination and order of the Tax Court of the

United States rendered herein on April 7, 1944, reported in 3 T. C. 585.

II.

The Jurisdiction of This Court.

The jurisdiction of this Court is invoked under Sec. 240 (a) of the Judicial Code (8 F. C. A., Tit. 28, §347).

This proceeding involved alleged additional income taxes for the calendar year 1938. The 90-day letter of the Commissioner of Internal Revenue claiming a deficiency of $1,932.99 was mailed on January 5, 1942. The petition to the Tax Court of the United States (then Board of Tax Appeals) was filed on April 1, 1942. The findings of fact and opinion of the Tax Court were promulgated on April 7, 1944. The decision of the Tax Court determining a deficiency of $27.77 was entered on May 19, 1944. On August 16, 1944, the Commissioner filed his assignments of error and petition for review by the Circuit Court of the United States for the Second Circuit. The decision of the Circuit Court of Appeals for the Second Circuit reversing the Tax Court was rendered on December 28, 1945.

III.

Statement of the Matters Involved.

The facts were simple and undisputed.

William M. Crane, a resident of the State of New York, died on January 11, 1932. At the time of his death he owned real estate in Brooklyn, New York, improved by an apart-

ment house. The real estate was subject to a mortgage then in default, made by a former owner of the property, the Rell Realty Company. This mortgage was held by the Bowery Savings Bank of New York, and there was due upon it at the time of his death principal of $255,000 and interest in arrears of $7,042.50, or a total of $262,042.50. The value of the real estate as appraised in federal estate tax proceedings was $262,042.50.

Under the residuary clause of Mr. Crane's will, the property passed to his wife, Beulah B. Crane, the petitioner herein. She did not assume the mortgage and was not liable upon it or obligated to pay it in any way. During all the time she owned it, the apartment house was managed by the Bowery Savings Bank under an assignment of rents. Mrs. Crane received no income or other benefit from the property.

Between 1932 and 1938, the estate in its income tax returns for 1932 and 1933, and Mrs. Crane in her income tax returns for subsequent years showed deductions for depreciation on the building of $25,500. Such deductions were greater than the income from all sources otherwise taxable, and the tax benefit to the estate and to Mrs. Crane was only a nominal amount.

In October, 1938, in order to avoid foreclosure, Mrs. Crane made a contract to sell her equity in the property for $3,000. The contract provided:

> "The purchase price is Three Thousand Dollars ($3,000) for the equity conveyed by the seller and without deduction for the mortgage principal, interest or taxes, or meter charges hereinabove referred to."

On November 29, 1938, Mrs. Crane conveyed the real estate to the purchaser subject to the foregoing mortgage,

upon which, as previously stated, she was not liable. The purchaser did not pay or assume or agree to pay the mortgage. At that time, the amount due on the mortgage was $255,000 of principal and $15,857.71 of interest, or a total of $270,857.71.

Mrs. Crane received $3,000 in cash. She received no release of the mortgage debt. Expenses of sale were $500. "The amount realized by the petitioner from the sale, therefore, was $3,000, less the $500 paid for conveyancing, or $2,500" (3 T. C. 586).

The foregoing facts were found by the Tax Court (with the exception of the amount of her tax benefit, which was shown by the evidence, but as to which the Tax Court made no finding one way or another).

In her income tax return for 1938, Mrs. Crane reported a capital gain of $2,500. The Commissioner of Internal Revenue claimed that the gain was $24,031.45, divided between ordinary gain on the building and capital loss on the land in proportions stipulated by the parties.

The applicable provisions of the Revenue Act are shown in the accompanying brief.

The Tax Court found that Mrs. Crane's gain was $2,500, apportioned between the land and building in the manner stipulated; that her unadjusted basis was zero, which was not capable of reduction for depreciation below zero; that she received only $2,500; that the mortgage of $262,042.50, upon which she was not liable, formed no part of the consideration received or "amount realized" by her.

Judge Tyson wrote the opinion of the Tax Court which was reviewed by the full Court. Judges Smith and Disney dissented without opinion.

This resulted in a deficiency of $27.77 from which no petition or cross-petition for review was filed by Mrs. Crane.

The Circuit Court of Appeals, Second Circuit, reversed the Tax Court and, without discussing the figures, sustained the Commissioner's determination, viz.: that Mrs. Crane's gain was $24,031.45; that her unadjusted basis was $262,042.50; that her adjusted basis was $234,997.40; and that the amount realized was $257,500, which included the cash of $2,500 and the principal amount due on the mortgage.

Circuit Judge Learned Hand wrote the opinion, in which Judge Frank concurred. Circuit Judge Swan dissented upon the opinion of the Tax Court.

IV.

The Questions Presented.

(1) Whether the findings of the Tax Court of the United States as to the amount realized upon the sale, the basis of the property sold, and the amount of the gain upon the sale, were subject to review and reversal by the Circuit Court of Appeals.

(2) Whether the principal amount due on the defaulted mortgage of $255,000, which was a lien upon the property when Mrs. Crane inherited it, and for the payment of which Mrs. Crane was not liable under the law of the State of New York, was part of the "amount realized" by Mrs. Crane from the sale; or, specifically, whether the "amount realized" was $2,500 as held by the Tax Court, or $257,500, as claimed by the Commissioner and as held by the Circuit Court of Appeals.

(3) Whether the "unadjusted basis" of the mortgaged property received by Mrs. Crane under her husband's will was the value of her equity or the value of the real estate free from the mortgage; or, specifically, whether the

"unadjusted basis" was zero as held by the Tax Court, or $262,042.50 as claimed by the Commissioner and as held by the Circuit Court of Appeals.

(4) Whether the "unadjusted basis" of zero can be reduced through the deduction of depreciation so as to create a fictitious "adjusted basis" of a minus quantity; or, specifically, whether the "adjusted basis" for gain or loss was zero, as held by the Tax Court, or minus (—) $28,045.10, as claimed by the Commissioner. Alternatively, as suggested by the Court upon the argument, whether depreciation on the building should be included in the "amount realized" upon the sale in 1938, and, if so, whether the amount to be included was the depreciation "allowed or allowable", or the depreciation which resulted in tax benefit for Mrs. Crane.

(5) Whether the imposition of an "income" tax on a fictitious "gain" of $24,031.45, when in fact Mrs. Crane only received $2,500, was authorized by Article I, Section 8 and the 16th Amendment of the Constitution, or violated Article I, Section 9 and the 5th Amendment of the Constitution.

V.

Grounds for Granting the Within Petition.

(1) The said decision and judgment of the United States Circuit Court of Appeals, Second Circuit, is in conflict with the applicable decisions of this Court, viz.: *John Kelly Co.* v. *Commissioner*, U. S. , decided January 7, 1946 and *Dobson* v. *Commissioner*, 320 U. S. 489. The *Kelly* case removed the prevailing misapprehension as to the continued force of the *Dobson* case, but

was decided after the Circuit Court of Appeals had rendered its decision herein, and hence did not come to the Court's attention until too late to be given effect.

(2) The said decision and judgment of the United States Circuit Court of Appeals, Second Circuit, is in conflict with the decision of the United States Circuit Court of Appeals, Fifth Circuit, in *Hilpert* v. *Commissioner*, 151 F. 2d 929, and in conflict with the decisions of the United States Circuit Court of Appeals, Third Circuit, in *Stokes* v. *Commissioner*, 124 F. 2d 335, and *Polin* v. *Commissioner*, 114 F. 2d 174 (see also *Commissioner* v. *Green*, 126 F. 2d 70), wherein it was held that the amount of a mortgage or other encumbrance to which the real estate was subject, formed no part of the "amount realized", where the seller was not personally liable for the payment of the bond, mortgage, or other obligation. It was also inconsistent with the Second Circuit's decision, *Bingham* v. *Commissioner*, 105 F. 2d 971, and decisions of the Court of Appeals of the District of Columbia, *Hale* v. *Helvering*, 85 F. 2d 819, and of the Fifth Circuit, *Turney's Estate* v. *Commissioner*, 126 F. 2d 712, relating to transfers to the mortgagee without cash consideration, which hold that the amount of the mortgage was not part of the "amount realized" at least where there was no substantial personal liability or where no release of personal liability was given.

(3) The United States Court of Appeals, Second Circuit, has decided an important question of local law, viz., the nature and extent of the obligation of the owner of mortgaged real estate, and the effect of a conveyance thereof, subject to such mortgage,—in a manner contrary to the statutes and decisions of the State of New York wherein the mortgaged real estate was situated, which hold that (a) where real estate is sold "subject to" an existing mortgage

which the purchaser does not assume or agree to pay, the real estate is the primary fund for the payment of the mortgage and the purchaser is under no obligation to discharge it (*Belmont* v. *Cowan*, 22 N. Y. 438), (b) in such case the amount of the mortgage debt is not part of the consideration for the purchase (*Smith* v. *Truslow*, 84 N. Y. 660, 662), (c) a conveyance of the mortgaged real estate by an owner who was not liable for the mortgage debt cannot affect the rights of the mortgagee in respect to the mortgaged realty, or as against any persons liable for the mortgage debt (*Marshall* v. *Davies*, 78 N. Y. 414), and (d) in the case of a mortgage such as the one in the case at bar, executed prior to September 1, 1933, the extent of such liability, where it exists, is not the total amount due on the mortgage, but is measured by the difference between the amount due on the mortgage with interest and costs, less the market value as determined by the Court or the foreclosure sale price whichever is higher (New York Civil Practice Act, Sec. 1083-a; *Matter of Burrows*, 283 N. Y. 540, 545).

(4) The United States Circuit Court of Appeals, Second Circuit, has construed the Revenue Act in a manner contrary to the 16th Amendment, and in violation of Article I of the Constitution and the 5th Amendment thereto, in that the said Court has imposed an "income" tax of $1,932.99 upon a fictitious "gain" of $24,031.45, when in fact Mrs. Crane only received, directly or indirectly, in money, property, value, or otherwise the sum of $2,500.

(5) The United States Circuit Court of Appeals, Second Circuit, has decided important questions of tax law hereinbefore specifically enumerated in this petition, which have not been but should be settled by this Court.

(6) In each of the foregoing respects, the said decision and judgment of the United States Circuit Court of Appeals, Second Circuit, so far departed from the accepted and usual course of judicial procedure as to call for an exercise of this Court's power of supervision.

VI.

Petitioner begs leave to amplify her arguments and reasons for granting the writ, in the brief which is herewith submitted.

VII.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued under the seal of this Court directed to the United States Circuit Court of Appeals for the Second Circuit, sitting at New York, N. Y. commanding that Court to certify and send to this Court on a day to be designated, a full and complete transcript of the record and of all proceedings had by the Circuit Court of Appeals in said cause, to the end that this cause may be reviewed and determined by this Honorable Court, that the said decision and judgment of the Circuit Court of Appeals be reviewed by this Honorable Court; and that your petitioner be granted such further relief as may seem proper.

And your petitioner will ever pray.

BEULAH B. CRANE,
Petitioner.

UNITED STATES OF AMERICA,
SOUTHERN DISTRICT OF NEW YORK, } ss.:

BEULAH B. CRANE, being duly sworn, deposes and says:

That she is the petitioner herein; that she has read the foregoing petition subscribed by her, and that the facts stated therein are true to the best of her knowledge, information and belief.

BEULAH B. CRANE.

Sworn to before me this
19th day of March, 1946.

ALBERT GRIMECK
Notary Public, Queens County
Certificate filed in New York County
Commission expires March 30, 1947

I hereby certify that I have examined the foregoing petition; that in my opinion it is well founded and entitled to the favorable consideration of the Court, and that it is not filed for the purpose of delay.

Dated, March 19, 1946.

EDWARD S. BENTLEY,
Counsel.

Supreme Court of the United States

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BRIEF IN BEHALF OF PETITIONER.

I.

The Applicable Statutes.

The statutory formula for determining gain or loss is simple.

Sec. 111(a) of the Revenue Act of 1938, which governed the tax for the year in question provided:

> "(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis, provided in section 113(b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized".

In other words, this subdivision provided that in computing gain or loss only two elements were to be considered, viz.: (1) The amount realized from the sale; and (2) the adjusted basis provided in Sec. 113(b). If the amount realized from the sale was greater than the adjusted basis, there was a gain.

We shall state these elements in order.

(a)

The "amount realized" was defined in Sec. 111(b) thus:

> "(b) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of property (other than money) received".

(b)

Coming now to the "adjusted basis", it was provided in Sec. 113(b) as follows:

> "(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a) adjusted as hereinafter provided".

In other words, it was necessary first to establish the "basis" under Sec. 113(a), and then to "adjust" this basis in accordance with Sec. 113(b).

It was stated in Regulations 103, Sec. 19.113(a)-1:

> "The basis of property for the purpose of determining gain or loss from the sale or other disposition thereof is the unadjusted basis prescribed in Sec. 113(a), adjusted for the various applicable items specified in Sec. 113(b)".

Subdivision (5) of Sec. 113(a) of the 1938 Revenue Act defined the basis to be used in this case. It read:

> "(5) *Property Transmitted at Death.*—If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition".

(c)

The method of determining the "adjusted basis" was laid down in sub-division (1) of Sec. 113(b) as follows:

> "(1) *General Rule.*—Proper adjustment in respect of the property shall in all cases be made—
>
> (A) • • •
>
> (B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization and depletion, to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws".

II.

The reversal of the Tax Court by the Circuit Court of Appeals was a glaring violation of the rule of this Court in *Dobson* v. *United States*, 320 U. S. 489. The findings upon which the decision of the Tax Court was based, were not subject to review by the Circuit Court of Appeals.

The Tax Court made the following findings:

(a) As to the amount realized.

> "The facts show and the respondent (Commissioner) concedes, that petitioner received money to the extent of only $2,500 from the sale.

"As she (Mrs. Crane) was never under any personal obligation to pay the mortgage debt she received no consideration whatever when she sold and conveyed the property subject to the mortgage, except the $2,500 in money mentioned above.

"Except for the $2,500, the petitioner thus did not receive money, or the equivalent of money, or property (other than money) having a fair market value.

"The amount realized by the petitioner from the sale, therefore, was $3,000 less the $500 paid for conveyancing, or $2,500."

(b) As to the unadjusted basis.

"The property when acquired by the petitioner was encumbered by a mortgage in an amount which, together with the accrued interest thereon, was equal to the fair market value of the property.

"The interest of petitioner in the apartment house property had no fair market value whatever when acquired by her."

(c) As to the adjusted basis.

"We have *determined* that the unadjusted basis of the property in question, under section 113(a)(5), is zero, and, this being true, there is, in the very nature of things, nothing to adjust—nothing from which depreciation can be deducted."

(d) The Tax Court's computation.

"We conclude and so hold that the proper basis to be used in computing petitioner's gain is zero, and, as the amount realized by her from the sale of the property was only $2,500, that her gain from the sale is in the same amount."

Having thus found as a fact that the minuend was $2,500 and that the subtrahend was zero, the ascertainment of the

gain of $2,500 and the computation of the tax thereon was a simple arithmetical problem.

From a reading of the statutory formula and definitions quoted in our Point I, several conclusions necessarily follow:

(1) Under no circumstances can the gain exceed the "amount realized" as defined in Sec. 111(b).

(2) Depreciation, where it enters into the formula, reduces the "basis". It cannot be used to increase the "amount realized".

When, therefore, the Tax Court made its finding that the "amount realized" by Mrs. Crane was $2,500, it seems to us self-evident that such finding should have ended the case, and that no counter-finding of fact or conclusion of law by the Circuit Court of Appeals was possible under the law to reverse the Tax Court's judgment.

The Circuit Court of Appeals, however, with Judge Swan dissenting, took a different view.

Premising its remarks with the following observation:

> "The appeal does not concern the figures; it only raises the question whether the taxpayer is right—as the Tax Court held, two Judges dissenting—in insisting that the only gain for which she was taxable was the $2,500 which she received upon the sale",

the Circuit Court of Appeals substituted for the Tax Court's findings, the following findings of its own:

> (*a*) *As to the amount realized.*
>
> "When therefore upon a sale the mortgagor makes an allowance to the vendee of the amount of the lien, he secures a release from a charge upon his property quite as though the vendee had paid him the full price on condition that before he took title the lien should be cleared, or as though it were a condition

upon the sale of Whiteacre that the vendee should clear the vendor's Blackacre of a mortgage. In neither case would anyone question the conclusion that the vendor had received 'property (other than money)'; yet the effect is precisely the same of the transaction at bar."

In figures, this meant that the amount realized, including the mortgage principal was $257,500.

(*b*) *As to the unadjusted basis.*

"Section 113(a)(5) defines the "unadjusted basis" of property in the case of a devise as its "fair market value" when it was acquired, which in the case at bar was its appraised value as part of the devisor's estate."

This made the unadjusted basis $262,042.50.

(*c*) *As to the adjusted basis.*

"We cannot doubt, especially in view of the long uniform practice, that the right "basis" for depreciation is the actual value of the buildings".

The depreciation so computed was $28,045.10, which gave a figure of $178,997.40 as the adjusted basis of the building, and $55,000 for the land.

(d) The computation of the Circuit Court of Appeals.

As stated, the Circuit Court of Appeals did not concern itself with figures. The actual result was a gain of $24,031.45 for the building all of which was recognized and a loss of $528.85 on the land, 50% of which was recognized.

In thus reversing the Tax Court's findings, and substituting findings of its own, and adopting the tax computations of the Commissioner, the Circuit Court of Appeals committed a clear violation of the rule of the *Dobson* case.

Matters relating to gain or loss, and the basis for the purpose of determining gain or loss, including the amount which was realized on the sale and the allowance, if any, for depreciation, are essentially matters for determination by the "Exchequer Court", the Tax Court of the United States.

Dobson v. *United States*, 320 U. S. 489;
McDonald v. *Commissioner*, 323 U. S. 57, 64;
John Kelly Company v. *Commissioner*, ' U. S.

Even if the determination of such elements was not a pure finding of fact, it fell within that class of mixed questions of fact and law which this Court held in the *Kelly* case, were exclusively for determination by the Tax Court and not subject to review by the Circuit Court of Appeals. Indeed, the language which this Court used in the *Kelly* case might well have been spoken in the case at bar.

If the decision of this Court in *Kelly Company* v. *Commissioner*, had preceded the decision of the Circuit Court of Appeals in this case, and had been brought to its attention, it is inconceivable that the Circuit Court of Appeals would have reversed the Tax Court. Any doubts in the minds of the Judges of the Circuit Court of Appeals as to the effect to be given to the *Dobson* case would have been dispelled by the emphatic language of this Court in the *Kelly* case.

Clearly then, this flagrant disregard of the principles repeatedly announced by this Court should not pass unnoticed, and this Court should issue its writ of certiorari to the Circuit Court of Appeals, Second Circuit, in order to set the matter right, and avoid that incentive to further violations of the *Dobson* rule which would otherwise necessarily ensue.

III.

The holding by the Circuit Court of Appeals, Second Circuit, that the amount realized by Mrs. Crane on the sale included not only the cash of $2,500 received on closing, but also the sum of $255,000 unpaid principal of the mortgage for which Mrs. Crane was not liable, was in conflict with the decisions of the Circuit Court of Appeals, Fifth Circuit, and Circuit Court of Appeals, Third Circuit, referred to in the foregoing petition.

When the case at bar was argued and briefed, the opinion of the Circuit Court of Appeals, Fifth Circuit, in *Hilpert* v. *Commissioner*, 151 F. 2d 929, had not been announced and was not available to Court or counsel.

In its essentials, there is little difference between the *Hilpert* case and the case at bar. Mr. and Mrs. Hilpert owned real estate in Florida. In consideration of $65,000 they conveyed it to the lender subject to a repurchase agreement exercisable at their option. The Florida Court held that this was an equitable mortgage under which they had the right to redeem. Pending the decision of the Florida Court, they made a contingent contract to sell the real estate for $17,067.67 cash, and the purchaser agreed to pay the money necessary to redeem. Following the decision of the Florida Court title was closed. It was conceded that the Hilperts were not liable on the mortgage. The question arose whether the redemption price was part of the "amount realized" by the Hilperts on the sale.

The Tax Court announced the same rule which it adopted in the case at bar. It said:

> "There is no dispute as to basis. The controversy relates to the amount of the consideration. It is true

that all that petitioners received upon the sale was the cash paid to them by the vendees. * * *"

"* * * Only when the facts are so peculiar that the mortgage neither constitutes a liability of the seller nor is responsible for a part of the aggregate benefit received can it safely be eliminated from the computation of gain."

For reasons not material here, the Tax Court held that the rule did not apply.

The Circuit Court of Appeals, Fifth Circuit, reversed the Tax Court, and held that the amount of the mortgage or redemption price was not part of the amount realized by the Hilperts.

The Circuit Court of Appeals said:

"We find no fault with the foregoing statement of legal principles but only in their application to the peculiar facts in this case. We think that the Tax Court erred in its view as to what the Hilperts received."

It concluded:

"Since there was no note, no covenant, and no agreement to repay the $65,000, and no enforceable obligation against the Hilperts in the transaction, the Tax Court was wrong in holding that the payment of the $54,364.67 by Lawton Investment Company in redeeming the property was a benefit received by the sellers out of that purchase. The case clearly comes within the exception stated by the Tax Court that when the mortgage neither constitutes a liability of the seller nor is responsible for a part of the aggregate benefit received it is appropriate that the amount paid by another to redeem property from the mortgage should be eliminated from the computation of gain to the mortgagor.

> "Since there was no personal liability that could accrue against the Hilperts, all that they got out of the transaction was the $17,067.67."

There are also the decisions in the Third Circuit.

> *Stokes* v. *Commissioner*, 124 F. 2d 335;
> *Polin* v. *Commissioner*, 114 F. 2d 174;
> *Commissioner* v. *Green*, 126 F. 2d 70.

In *Stokes* v. *Commissioner, supra,* a dummy or "straw man" was liable on the bond. The Commissioner claimed that an agreement existed to release the "straw man" and that a conveyance of the mortgaged property to the mortgagee operated as a release of the owner, thereby providing consideration for the conveyance sufficient to characterize the transaction as a sale.

Commenting on the Commissioner's argument, the Third Circuit said, at page 338:

> "None of this has the ring of reality to one who knows only a little of Pennsylvania mortgage law and practice (citing cases). And in Pennsylvania it is not to be disputed that a beneficial owner is not liable on the bond of a straw party . . . Furthermore, it does not appear that a release of the straw parties was bargained for when the security was surrendered."

The Court continued:

> "If no such bargain was made, the surrender of security is not converted into a sale or exchange by any assumption, correct or otherwise, that the law implied a release because of the surrender."

In *Polin* v. *Commisisoner*, 114 F. 2d 174, the taxpayer, at the time of the foreclosure of the mortgage, was given a release from liability on the mortgage bond. The Commis-

sioner claimed that thereby he had received property (other than money), equal in value to the amount due on the mortgage, plus interest. It was proven, however, that the taxpayer had received a release some ten years before, so that actually he received nothing at the time of the foreclosure. The Circuit Court of Appeals, Third Circuit, held that the taxpayer had received nothing which could be made subject to an income tax, thereby reversing both the Commissioner of Internal Revenue and the Board of Tax Appeals which had sustained the Commissioner's position.

Circuit Judge Jones said, at page 176:

> "The petitioner's release from liability on account of the obligations of the bond, for which the agreement of April 23, 1934, provided, furnished no consideration to the petitioner and his associates for their action in surrendering the property to the mortgagee. The bond itself had already provided that the obligors' liability for the obligations of the bond should be limited to the property conveyed by the mortgage securing the bond and that no other property of the obligors should be taken in satisfaction of the bond's requirements. This limitation upon the obligee's right to recovery applied to the obligor's promise to pay taxes on the mortgaged property as well as to their promises to pay the principal and interest called for by the bond. The provision in the agreement relieving the obligors of any personal liability under the bond was no more than a repetition of what the obligee had stipulated in the bond. The agreement of April 23, 1934, did not, therefore, relieve the petitioner from anything for which he was liable to the obligee and, consequently, he received nothing in exchange for his part in turning over the mortgaged property to the mortgagee."

See also *Commissioner* v. *Green*, 126 F. (2d) 70, where the seller had not assumed or agreed to pay, was treated as

no part of the "amount realized" upon the conveyance of the mortgaged property. See also the discussion in *Stamler* v. *Commissioner*, 145 F. 2d 37.

No argument is needed to show the conflict between those decisions and the decisions of the Second Circuit in the case at bar.

There is also the line of decisions dealing with transfers of the mortgaged property to the mortgagee in lieu of foreclosure.

Bingham v. *Commissioner*, 105 F. 2d 971;
Hale v. *Helvering*, 85 F. 2d 819;
Turney's Estate v. *Commissioner*, 126 F. 2d 712.

In no such case that has been brought to our attention was the amount of the mortgage debt considered "amount realized" by the transferor, unless the transferor was liable for the debt and the debt was discharged, or unless there was a cash consideration as in *Blum* v. *Commissioner*, 133 F. 2d 447.

If Mrs. Crane had conveyed this real estate to the mortgagee, the Bowery Savings Bank, subject to the mortgage, without cash consideration, Judge Hand's statement that she "secures a release from a charge upon his property quite as though the vendee had paid him the full price on condition that before he took title the lien should be cleared", would have applied just as much as to the actual transaction, where she conveyed it to Avenue C Realty Corporation and received $2,500 in cash. Yet in the case supposed, there would have been no "amount realized" and no tax.

We fail to comprehend why the identity of the transferee, or the presence of a single peppercorn, or "six cents", or $100, or $2,500, should control whether the mortgage was part of the "amount realized" by the transferor. Undoubt-

edly, the cancellation of the debt, if there is a debt, or a release of liability, if there is liability, constitutes property received. But where the debt remains and no liability is released or discharged, the decision that the mortgage was "amount realized" in the case at bar, was inconsistent with the decisions of the other circuits, holding that it is not "amount realized" where the transferee happens to be the mortgagee.

We do not disagree with those decisions which refuse to superimpose the burden of an income tax upon an owner who has suffered the disaster of losing his property.

We submit—and we do not see how it can be validly controverted—that the decision of the Circuit Court of Appeals in the case at bar is in conflict with all such cases yet decided in the various federal appellate courts of the country.

IV.

The decision and judgment of the Circuit Court of Appeals was contrary to the settled law of the State of New York in which the mortgaged real estate was situated.

The distribution of the mortgaged real estate to Mrs. Crane under the residuary clause of her husband's will did not impose upon her a personal liability for the debt. This was found by the Tax Court, and the Circuit Court of Appeals concurred.

Under the law of New York, the real estate was the primary source of payment of the mortgage debt, and Mrs. Crane in no event was liable for a deficiency judgment.

Hauselt v. *Patterson*, 124 N. Y. 349, 357.

When Mrs. Crane sold the property subject to the mortgage, no change in the mortgage relationship occurred. She was under no liability before the sale, and she was under no liability afterward. The mortgaged property continued to be the primary source for the payment of the mortgage debt regardless of the change of ownership. The purchaser assumed none of the obligations of the mortgage. The position of the mortgagee remained unchanged, and could not be affected by a transaction to which he was not a party.

This was the well settled law of New York.

Belmont v. *Coman*, 22 N. Y. 438;
Dingeldein v. *Third Avenue R. R. Co.*, 37 N. Y. 575;
People ex rel. Banner Land Co. v. *State Tax Commission*, 244 N. Y. 159.

Consequently, when the Circuit Court of Appeals injected into this simple and common transaction a new element which would in effect momentarily satisfy and discharge the existing mortgage and substitute a new one, thereby bringing into existence a property right valued at $255,000, the Court created a novel concept, unknown to the law of New York and contrary to its firmly established decisions.

Smith v. *Truslow*, 84 N. Y. 660, 662.

Even if we should assume for the purpose of argument the correctness of the Court's theory of property rights arising from the sale, the value of $255,000 attributed to the "property" which Mrs. Crane was held to have received, cannot be sustained under the law of New York.

Such valuation can only be based on the assumption that the "liabilty" so "discharged" was $255,000. (Actu-

ally, it was $270,857.71 if we add to the mortgage principal of $255,000 for which Mrs. Crane was not liable, the mortgage interest of $15,857.71, for which she also was not liable and which she never received.)

The law of New York, however, in its mortgage moratorium statute forbids liability in such unconscionable amounts, and in the case of a moratorium mortgage such as this, executed prior to July 1, 1932, provides that a deficiency judgment, if granted, shall be the amount due on the mortgage with interest and costs less the market value as determined by the Court, or the sales price upon the foreclosure sale, whichever is greater (Civil Practice Act, Sec. 1083-a).

It is self-evident that even if Mrs. Crane had been personally liable on the bond and mortgage, no deficiency judgment could have been recovered against her. *Heiman* v. *Bishop*, 272 N. Y. 83.

When, therefore, the Circuit Court of Appeals held that Mrs. Crane by reason of the sale received "property (other than money)" having a "fair market value" of $255,000, it disregarded those salutary New York statutes enacted for the purpose of preventing the assertion of any such claim.

The decision of the Second Circuit was contrary to local law and should be reviewed by this Court.

V.

Mrs. Crane received no income within the meaning of the 16th Amendment except the sum of $2,500 on which she paid an income tax. The determination of the Second Circuit Court that she received income of $24,031.45, if required by the Revenue Act, violated Article I of the Constitution and the 5th Amendment thereto.

The shocking injustice of imposing an "income" tax of $1,932.99 upon a fictitious "gain" of $24,031.45, when in fact Mrs. Crane only received the sum of $2,500, compels consideration of the constitutional safeguards enjoyed by American citizens against arbitrary impositions of this character.

It is well settled that the 16th Amendment did not enlarge the field of taxation open to Congress under Article I, Section 8 of the Constitution, but simply removed in the case of a tax on income the restrictions as to uniformity and apportionment imposed upon the taxing power of Congress by Section 9 of that Article.

We may concede that the power of Congress to tax its citizens has few, if any, limits. We may even grant, at least for the purpose of this argument, that Congress has power under the Constitution to make a capital levy for the support of the Government.

But in such case, as in the case of every tax under Article I of the Constitution, except only an income tax as to which special provision is made in Amendment 16, the requirements as to uniformity and apportionment among the several States must be observed.

Pollock v. *Farmers Loan & Trust Co.*, 158 U. S. 601.

Therefore, if the Revenue Act of 1938 should be so construed as to characterize as "income" a fictitious figure which is not, in fact, income, derived by the use of mathematical imaginaries, a tax on such "income" cannot claim the protection of the 16th Amendment, and must fall because the requirements of Article I were not followed.

Eisner v. *Macomber*, 252 U. S. 189.

Applying these firmly established principles to the case at bar, a construction of the Revenue Act of 1938 which would attribute to Mrs. Crane a "gain" or "income" in excess of $2,500, could not meet the test of constitutionality.

Bowers v. *Kerbaugh-Empire Co.*, 271 U. S. 170;
Edwards v. *Cuba Railroad Company*, 268 U. S. 628;
Nicholas v. *Fifteenth Street Investment Company*, 105 F. (2) 289.

The meaning of the word "income" in the 16th Amendment is the same as when used in common speech.

Eisner v. *Macomber* (*supra*), at p. 207;
Sprouse v. *Commissioner*, 122 F. (2) 973, aff'd. 318 U. S. 604.

The action of a majority of the Second Circuit in the case at bar in transforming into a highly profitable transaction, an event which, in the ordinary meaning of language and by all dictates of common sense, was a ruinous disaster, emphasizes anew the need of the individual citizen for those safeguards against arbitrary governmental action

as established by the Bill of Rights and contained in the limitations of the Constitution.

When Mrs. Crane is singled out and told that her gain was $24,031.45 which she did not receive, instead of $2,500 which she did receive, if the statute justified the Court's decision, the need for constitutional protection is clear. If Mrs. Crane is treated thus, why should not her fictitious "income" be $240,314.50 or $2,403,145? Or any sum of money which approves itself to the Commissioner's fancy?

We respectfully submit that the alleged gain of $24,031.94 was not "income" within the meaning of the 16th Amendment, as laid down in the decisions of this Court cited under this point heading. The levying of a tax thereon was not an income tax within the purview of the 16th Amendment, but was, in fact, a capital levy made without apportionment and without regard to any census or enumeration, and consequently violated Article I, Section 9, and the 5th Amendment to the Federal Constitution.

VI.

Upon the grounds stated in the petition, and in this brief, a writ of certiorari should be granted to review the determination of the Circuit Court of Appeals in this case.

Respectfully submitted,

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